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Federal Communications Commission
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

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In the Matter of	)	
	)	
Puerto Rico Telephone Company's	)	**CC Docket No. 96-160**
New Expanded Interconnection Tariff	)	

OPPOSITION OF CORECOMM INCORPORATED TO PUERTO RICO TELEPHONE COMPANY'S DIRECT CASE

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CoreComm Incorporated ("CoreComm"), by its attorneys, hereby submits its Opposition to Puerto Rico Telephone Company's ("PRTC's") Direct Case regarding its New Expanded Interconnection Tariff.

INTRODUCTION AND SUMMARY

The rules governing the burden of proof in tariff investigations are straightforward. Section 204(a) provides that, at any hearing involving a new or revised charge, the carrier has the burden of demonstrating that the new or revised charge is just and reasonable.[1/] The Commission has long held that Section 204(a) requires carriers to bear the burden of proof on other issues of lawfulness as well as on rates.[2/] Pursuant to Section 204(a), the Commission designated PRTC's "Virtual Expanded Interconnection Tariff Filing" for investigation and required PRTC to make the necessary showing that the tariff rates are just and reasonable, that the tariff terms and conditions are not unduly discriminatory, and that it

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[1/] See 47 U.S.C. § 204(a); see also In the Matter of Beehive Telephone, Inc. v. The Bell Operating Companies, FCC 95-358, 78 R.R. 2d 1376, 1382 n.66 (1995).

[2/] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 4 FCC Rcd 2873, 3098 and n.984 (1989); In the Matter of AT&T and Western Union Private Line Rate Case, 34 FCC 217, 317 (1961); see also Referral of Chastain v. AT&T, 49 FCC 2d 749, 751 (1974), vacated on other grounds, 65 FCC 2d 25 (1977).

did not otherwise violate any statute, agency regulation or Commission order.[3/] In designating PRTC's tariff for investigation, the Commission found that PRTC's tariff raised significant questions of lawfulness regarding the rate structure, cost allocation methodology, and the terms and conditions of service underlying its proposed virtual expanded interconnection service ("VEIS").[4/]

PRTC's Direct Case entirely fails to make the required showing required by Section 204(a). First, PRTC's rate structure does not comport with the Commission's requirements that a local exchange carrier's ("LEC's") rate structure reflect cost-causation principles and that rate elements be unbundled on a level sufficient to ensure that interconnectors are not forced to pay for services that they do not need.[5/] Second, PRTC attempts to justify its unreasonably high virtual expanded interconnection rates by overstating its direct costs and overhead loading factors. Third, PRTC's tariff contains certain terms and conditions that have been structured so as to discriminate against interconnectors in violation of PRTC's Title II obligations. Accordingly, CoreComm respectfully requests that the Commission reject PRTC's tariff as unjust and unreasonable in contravention of Sections 201 and 202 of the Communications Act.

[3/] See generally In the Matter of Investigation of PRTC's New Expanded Interconnection Offerings, PRTC Revisions to Tariff F.C.C. No. 1, Transmittal No. 2, CC Docket No. 96-160, Order (rel. August 14, 1996) ("Suspension Order"); Order Designating Issues for Investigation, (rel. March 11, 1997) ("Designation Order").

[4/] See Designation Order at ¶ 5.

[5/] See Designation Order at ¶ 8 (citing Expanded Interconnection with Local Telephone Facilities, CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154, 5186 (1994)) ("Virtual Collocation Order").

ARGUMENT

I. PRTC'S RATE STRUCTURE FOR VIRTUAL COLLOCATION DOES NOT COMPORT WITH THE COMMISSION'S RULES

The Commission requires that an incumbent LEC's rate structure for virtual collocation reflect cost-causation principles while unbundling rate elements on a level sufficient to ensure that interconnectors are not forced to pay for services that they do not need.[6] The Commission's virtual collocation provisions are fully consistent with the Telecommunications Act of 1996 ("1996 Act"), which requires all incumbent LECs, including PRTC, to provide unbundled network elements for collocation and set prices for unbundled elements that are cost based and nondiscriminatory.[7] To ensure a full and fair competitive marketplace, VEIS rates should be determined using a forward-looking incremental cost methodology.

PRTC has failed to comply with the requirements that PRTC's rate structure reflect cost-causation principles while unbundling rate elements on a level sufficient to ensure that interconnectors are not forced to pay for services that they do not need.[8] Rather than providing meaningful cost information, PRTC has simply repackaged embedded cost data already deemed inadequate by the Commission and has proposed that the Commission ratify rates for cross-connects that must be paid on what amounts to be an individual case basis

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[6] See id.

[7] See 47 U.S.C. § 251(c)(6); 252(d).

[8] Designation Order at ¶ 8 (citing Virtual Collocation Order, 9 FCC Rcd at 5186).

("ICB"), with charges assessed on a time and materials basis.[9] PRTC's ICB methodology is improper because it violates the Commission's requirement that the cross-connect element be provided pursuant to generally available tariffs at study-area-wide averaged rates.[10] As Centennial Cellular Corp. ("Centennial") previously noted, the Commission should not allow PRTC to use its "time and materials" approach because it would provide PRTC with the opportunity and incentive to treat interconnectors in a discriminatory and anticompetitive fashion, and would circumvent the Commission's rate review process.[11] PRTC's Direct Case provides no additional information from which the Commission can decide that PRTC's rate structure comports with the Commission's orders, and its attempt to obtain special treatment from the Commission for its tariff should be rejected.

PRTC's rate structure is deficient for other reasons as well. For example, PRTC's Direct Case ignores the Commission's requirement that before PRTC may charge for materials, it must provide the Commission and interested parties with a detailed list of: (1) for what materials PRTC proposes to charge when it performs these functions; and (2) how those charges are to be calculated.[12] Instead, PRTC has responded that it cannot supply the requested information because PRTC is unable to provide a "definitive list of charges for

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[9] See In the Matter of PRTC's New Expanded Interconnection Tariff, CC Docket No. 96-160, PRTC Direct Case at 2-5 (filed Apr. 10, 1997) ("PRTC Direct Case").

[10] See Designation Order at ¶ 18 (citing Expanded Interconnection with Local Telephone Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7442 (1992) ("Special Access Expanded Interconnection Order").

[11] See Designation Order at ¶ 10.

[12] See Designation Order at ¶ 18.

materials that would be used in every instance."[13] Thus, rather than provide a materials list and the underlying cost methodology from which the Commission and interested parties may discern the veracity of PRTC's rate structure, PRTC asks the Commission to allow it to continue assessing rates on a case-by-case basis and simply to trust PRTC to follow the principles of cost causation. The Commission should not condone this attempt to circumvent the Commission's rate review process as it creates overwhelming opportunities and incentives for discriminatory treatment of interconnectors.

II. PRTC HAS OVERSTATED ITS DIRECT COSTS AND OVERHEAD LOADING FACTORS

A. PRTC Has Improperly Inflated Its Direct Costs of Providing Virtual Expanded Interconnection Service

PRTC has inflated its virtual expanded interconnection rates to an unjust and unreasonable level, in part, by overstating the direct costs it incurs to provide the service. For example, PRTC proposes that it should be allowed to recover common area floor space as a direct cost in its virtual collocation rates.[14] As Centennial has noted in its Petition to Suspend and Investigate PRTC's tariff, however, including PRTC's proposed floor space as a direct cost allows double counting.[15] This occurs because PRTC's other comparable services recover square footage costs only through overhead loadings that are applied to the direct costs of special access services.[16] Thus, because PRTC has claimed to use these

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[13] See PRTC Direct Case at 2.

[14] See id.

[15] See Centennial Petition to Suspend and Investigate at 7-8 (filed May 21, 1996).

[16] Id.

same overhead loadings in developing its tariffed rates,[17] including a separate floor space rate element as a direct cost component will result in a double recovery of those costs. PRTC's attempt to recover floor space costs in this fashion is contrary to the pricing standards set forth in the Commission's Virtual Collocation Order and should be rejected.

PRTC's VEIS rates are also unreasonably high because PRTC's direct costs include a gross-up factor for the cost of money that is improperly premised upon federal income tax payments that PRTC does not make.[18] PRTC's receipt of compensation from CoreComm and other competitive local exchange carriers ("CLECs") for federal income tax payments that PRTC is not required to, and does not, make is contrary to the Commission's requirement that incumbent LECs develop rate structures for expanded interconnection that are based on principles of cost causation.[19] The Commission should reject PRTC's attempt to collect from competitors costs that PRTC has not actually incurred.

B. PRTC's Overhead Loading Factors For PRTC's Expanded Interconnection Service Rate Elements Are Unreasonably High

PRTC's rate level reflect unreasonably high overhead loading factors that range from 1.53 to 1.67.[20] These factors are significantly higher than similar Commission-authorized

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[17] See infra Section II.B.

[18] PRTC receives a Section 936 tax credit which fully offsets any federal tax payment it would be obligated to make. The statutory purpose of Section 936 was to stimulate development in Puerto Rico. See Letter from Russell M. Blau, Outside Counsel for KMC Telecom, Inc., to Regina Keeney, Chief, Common Carrier Bureau, FCC, dated April 21, 1997, attached hereto.

[19] See Designation Order at ¶ 8.

[20] PRTC Tariff FCC No. 1, Transmittal No. 2 at 18-20.

overhead loading factors imposed by other LECs.[21] PRTC's extraordinarily high overhead loading factors will likely prevent the development of an efficient competitive marketplace. Indeed, building large economic inefficiencies into PRTC's cost structure prevents interconnectors from offering consumers the prices levels that should result from competition. Yet, PRTC's unreasonably high overhead loading factors reflect precisely the unreasonably discriminatory practices that the Commission has previously sought to proscribe.

PRTC claims to have based its 1.53 overhead loading for the DS-1 Cross-Connect element on the ratio of price to direct cost for a point-to-point DS-1 circuit under the access rates filed in PRTC's Access Tariff.[22] Almost one year ago, however, Centennial demonstrated that PRTC's proposed overhead loadings were improperly calculated using a faulty utilization assumption that, when corrected, would yield an actual overhead loading associated with PRTC's DS-1 special access rates of 1.20, not the 1.53 level that it has claimed.[23]

Likewise, PRTC's 1.59 overhead loading for its DS-3 Cross-Connect element is overstated. As justification for this loading factor, PRTC relies, in large part, upon an unexplained 831% mark-up attributed to its Channel Mileage Facility ("CMF") service rates to arrive at this loading factor.[24] As a threshold matter, PRTC has not provided sufficient

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[21] See Centennial Petition at 9-10 (citing Commission-authorized overhead loading factors ranging from 1.20 to 1.40).

[22] See PRTC Direct Case at 14-15.

[23] See Centennial Petition at 11-14.

[24] See PRTC Direct Case at 14.

information from which interested parties can recreate the overhead loading factor for PRTC's CMF service. Assuming arguendo, that PRTC's 831% mark-up is correctly calculated, PRTC's CMF service rates still do not provide an appropriate comparison for the development of PRTC's VEIS overhead loading factor because the CMF rate violates the Commission's requirement that such unbundled elements be cost causative. By simply excluding PRTC's CMF loading factor, which should not be permitted to infect the VEIS overhead loading factor, the overhead loading associated with PRTC's DS-3 rates becomes 1.20, not the 1.59 level that PRTC has claimed.

Centennial has already demonstrated that PRTC's overhead loadings are unreasonably high and premised upon unacceptable assumptions.[25] Rather than provide any new evidence or argument to support its high overload loading factor, however, PRTC's Direct Case merely reiterates arguments the Commission correctly rejected when it designated PRTC's tariff for investigation. Because PRTC has not demonstrated that its overhead loading factors are justified, the Commission should prescribe lower recurring rates incorporating more reasonable overhead loadings (e.g., 1.20 to 1.25) on a permanent basis.

III. PRTC HAS NOT DEMONSTRATED THAT THE TERMS AND CONDITIONS OF ITS TARIFF ARE REASONABLE AND NONDISCRIMINATORY

A. PRTC's Liability Provision Is Excessive and Unreasonable

Under the tariff, PRTC may be held liable for physical damage to interconnectors' equipment if negligent, but may only be liable for interruptions or interference to

[25] See Centennial Petition at 11-14.

interconnectors' services if PRTC is found to have exercised willful misconduct.[26] In addition, PRTC's tariff contains a provision which indemnifies PRTC for any losses that:

> 'may arise out of or be caused by' the installation, maintenance, or repair of the interconnectors' designated equipment or any act or omissions of [PRTC] in connection with such equipment, and for any costs imposed on [PRTC] 'as a result of the interconnectors' presence in the central office.[27]

PRTC's threshold level for inadequate service is unreasonably high and, when combined with PRTC's indemnification of itself for any losses that result from its own "acts or omissions," further magnifies the discriminatory and unfair impact of the PRTC tariff for interconnectors.

One of the cornerstones of a successful interconnection arrangement, aside from rate terms, is the development and execution of adequate quality of service standards. Standards that do not properly hold incumbent LECs liable for interruptions or interference to interconnectors' services creates incentives for discriminatory treatment in situations in which the incumbent and its affiliates compete directly with the interconnector. For new entrants and other competitive providers, service defects and interruptions of even short duration are likely to be highly damaging to marketing efforts. Consequently, PRTC's attempt to limit its liability for service interruptions to damage caused by "willful misconduct" must be rejected.

Moreover, the tariff provisions that unilaterally allow PRTC to indemnify itself for any losses that result from its "own acts or omissions" are discriminatory. Incredibly, PRTC's tariff contains a provision that requires interconnectors to compensate PRTC for PRTC's own actions or omissions in connection with the "installation, maintenance and

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[26] See PRTC Tariff FCC No. 1, § 18.3.2(A).

[27] See PRTC Tariff FCC No. 1, § 18.3.2(B), (C).

repair of the collocators' equipment" that result in "any losses for damages to property and injury or death to persons."[28] PRTC's Direct Case, however, does not address the Commission's concerns regarding the reasonableness of PRTC's indemnification provisions,[29] but instead states, without more, that PRTC's indemnification provisions are reasonable because, "[i]f PRTC were required to assume greater liability, then its tariffed rates would have to reflect the increased risk it would face in providing virtual collocation under these circumstances."[30] PRTC has utterly failed to demonstrate that its liability provisions, which impose on interconnectors a more stringent standard of care than it establishes for PRTC,[31] are reasonable and nondiscriminatory,[32] and therefore, they should be rejected in their entirety.

B. PRTC Has Failed to Meet Its Burden to Demonstrate that Other Terms of the Tariff Are Reasonable and Non-Discriminatory

1. PRTC May Not Reserve Virtual Collocation for Itself While Making Its Offering to Others Subject to Space Availability

In its Direct Case, PRTC improperly maintains that it may refuse a request for virtual collocation whenever PRTC unilaterally decides that "space is limited to a great extent in the

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28/ See Designation Order at ¶ 86, citing PRTC Tariff FCC No. 1, § 18.3.2(B), (C).

29/ See id. at ¶¶ 81, 86.

30/ PRTC Direct Case at 19.

31/ See Designation Order at ¶¶ 81, 86.

32/ Similarly, the FCC should reject the PRTC tariff provision that unilaterally provides PRTC with a right of action against an interconnector that would survive the termination of the collocation arrangement for a minimum time of three years from the date of termination. See Designation Order at ¶¶ 86-87.

particular central office such that a specific arrangement is not feasible."[33] In addition, PRTC maintains that the Commission's virtual collocation orders allow PRTC to reserve space for its future use without qualification.[34] PRTC's representations cannot be reconciled with the Commission's explicit policies on space availability for virtual collocation. The Commission has stated that an incumbent LEC may retain a limited amount of floor space for defined future uses, and may withhold physical collocation from interconnectors in those instances.[35] Even in those limited cases, however, an incumbent LEC may not reserve space for future use for itself on terms more favorable than the terms that apply to other carriers seeking to reserve collocation space for their future use.[36]

The Commission has noted that, in rare instances, "space may be so limited in particular central offices that even virtual collocation is infeasible in those locations."[37] In such cases, however, an incumbent LEC must petition the Commission for a good cause

[33] PRTC Direct Case at 21.

[34] See id. at 21-22.

[35] See Local Competition Order at ¶ 604. Section 251(c)(6) clearly contemplates the provision of virtual collocation when physical collocation is not practical for technical reasons or because of space limitations. 47 U.S.C. § 251(c)(6). Section 251(c)(6) requires the incumbent LEC to demonstrate to the state commission's satisfaction that there are space limitations on the LEC premises or that technical considerations make collocation impractical. However, the Commission has explicitly stated that the exemption from the physical requirement due to space limitations will generally not be relevant to the Commission's "new mandatory virtual collocation requirements." See Virtual Collocation Order, 9 FCC Rcd at 5175.

[36] Local Competition Order at ¶ 604.

[37] See, e.g., Virtual Collocation Order, 9 FCC Rcd at 5174.

waiver of the virtual collocation requirement and demonstrate that collocation is infeasible.[38] The Commission may grant the waiver only when the petitioner has shown that "special circumstances" warrant a deviation from the generally applicable rule and that such a deviation would better serve the public interest than adherence to the requirement.[39] PRTC has yet to request such a waiver for any of its central offices. In any event, PRTC's Direct Case has not demonstrated, nor provided any support from which the Commission can find that PRTC's deviation from the Commission's virtual collocation orders are supported by good cause. Consequently, the Commission should reject as unlawful the provisions in PRTC's tariff making its virtual collocation offering subject to the availability of space.[40]

2. Requiring Potential Interconnectors to Provide Detailed Equipment Frame Layout Plans as a Prerequisite for Obtaining Virtual Collocation Is Unreasonable.

In the Virtual Collocation Order, the Commission reaffirmed its requirement that incumbent LECs offer virtual collocation of any type of transmission equipment reasonably requested by interconnectors.[41] The Commission explained that a broad interconnector right to designate equipment helps ensure that virtual collocation provides a realistic opportunity

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[38] See id. Any such sharing should require, at a minimum, the specific identification of the space on incumbent LEC premises that is used for various purposes, as well as specific plans for rearrangement/expansion and identification of steps taken to avoid exhaustion. See Local Competition Order at ¶ 602, n.1461.

[39] Northeast Cellular Tel. Co. v. FCC, 897 F.2d 1164, 1166 (D.C. Cir. 1990); WAIT Radio, 418 F.2d 1153 (D.C. Cir. 1969)

[40] See PRTC Tariff FCC No. 1, § 18.3.

[41] See Virtual Collocation Order, 9 FCC Rcd at 5070-71.

for access competition.[42] The Commission also found that the right to designate equipment is critical to enable interconnectors to determine the configuration of their circuits that terminate such equipment.[43] Thus, the Commission determined that incumbent LECs may only proscribe the use of interconnector-designated equipment or practices that represent a "significant and demonstrable technical threat" to the incumbent LEC network.[44] The Commission noted that such circumstances would be rare and expressed its intent to scrutinize carefully proposed prohibitions.[45]

Despite the Commission's clearly worded requirements regarding virtual collocation, PRTC's tariff has unlawfully created barriers for interconnectors attempting to obtain virtual collocation. Specifically, PRTC's tariff provides, in pertinent part, that interconnectors seeking virtual collocation service must, at the outset, submit a detailed "equipment frame layout [proposal] to PRTC [for PRTC's approval] before such equipment will be installed."[46] PRTC has indicated elsewhere that the layout proposal should include such details as "the size and type of equipment, the environment required for the equipment, the power requirements, the desired wiring requirements, and any other requirements for the proper operation of the equipment."[47] Upon receiving an interconnector's frame layout,

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42/ Id.

43/ Id.

44/ Id. at 5171.

45/ Id.

46/ Designation Order at ¶ 98, citing PRTC Tariff FCC No. 1, § 18.3.

47/ PRTC Direct Case at 22.

PRTC's tariff provides that PRTC may refuse an interconnector's request for virtual collocation by rejecting the interconnector's proposed layout plan within 30 days of its receipt.[48] PRTC's unconditional right to reject interconnectors' frame layout plans conflicts with the Commission's requirement that LECs offer virtual collocation of any type of transmission equipment reasonably requested by interconnectors.[49] Moreover, this tariff provision is contrary to the public interest because it will needlessly delay installation of virtual collocation equipment during the submission and review process.

Finally, PRTC has refused to respond to the Commission's request that PRTC identify the time intervals for installation of equipment that is used to provide DS1 and DS3 special and switched access.[50] Given the Commission's requirement in the Virtual Collocation Order that interconnector equipment be installed under the same time intervals that apply to PRTC's equipment for comparable services,[51] the Commission should not allow PRTC to benefit unfairly from its refusal to identify corresponding time intervals for comparable services. Instead, CoreComm requests that the Commission establish a time interval for PRTC for installation of equipment that is the equal to the average time intervals for installation of equipment used by the Regional BOCs to provide DS1 and DS3 special and switched access service.

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[48] See PRTC Tariff FCC No. 1, § 18.3.

[49] See Virtual Collocation Order, 9 FCC Rcd at 5070-71.

[50] See PRTC Direct Case at 24.

[51] See Virtual Collocation Order, 9 FCC Rcd at 5171.

3. PRTC Should Allow Interconnectors to Use Outside Contractors to Maintain and Repair Equipment Dedicated to the Interconnector's Use

PRTC has indicated that it will not honor an interconnector's request to allow outside contractors to maintain and repair transmission equipment because PRTC uses only its own employees or the equipment supplier for these purposes.[52] This refusal unnecessarily adds to the interconnector's costs of providing telephony services to its customers. As noted in the Virtual Collocation Order, the use of outside contractors may reduce LEC and interconnector costs by eliminating a LEC's need to train employees, particularly in cases when such employees do not routinely maintain or repair particular types of equipment.[53] While PRTC asserts that the interconnector will not be charged for training PRTC employees to work with unfamiliar equipment without the interconnector's direction,[54] the assertion has little effect on costs because the interconnector has no choice but to incur substantial training costs in instances where PRTC's employees perform non-routine functions. Accordingly, the Commission should reject PRTC's tariff provision as being contrary to the public interest as it does not provide the LEC with any incentive to maintain or install such equipment for interconnectors in an efficient manner.

Finally, PRTC's certification procedures regarding the installation of equipment appear to be unduly burdensome. As an initial matter, while PRTC maintains that it needs to verify the qualifications of the installer's employees on a case-by-case basis,[55] it is not clear

[52] See PRTC Direct Case at 26.

[53] See Virtual Collocation Order, 9 FCC Rcd at 5172.

[54] See PRTC Direct Case at 25-26.

[55] See PRTC Direct Case at 27.

whether these requirements are the same as the requirements used by PRTC to provide service for PRTC's equipment.[56] In addition, given that there is likely to be a relatively small number of outside contractors qualified to install such equipment in Puerto Rico, there appears to be no reasonable basis for PRTC's failure to develop certification requirements and an approved contractor list for outside contractors to install equipment. Accordingly, both the LEC and interconnector would derive mutual benefits from the use of certified representatives and would potentially simplify the operation of virtual collocation.

4. PRTC's Tariff Should Explicitly Provide That PRTC Will Install, Maintain and Repair Interconnector-Designated Equipment Under the Same Terms and Conditions that Apply for Comparable PRTC Equipment

As the Designation Order properly noted, PRTC's tariff does not provide that PRTC will comply with the Virtual Collocation Order's requirement that LECs install, maintain and repair interconnector-designated equipment under the time intervals and failure rates that apply to LEC equipment for DS1 and DS3 special access and switched transport services.[57] To comply with this requirement, the Commission should require that PRTC explicitly provide, at a minimum: (1) the frequency with which it will perform maintenance and repair of interconnector-designated equipment; (2) the maximum response time to intermittent service outages; and (3) the restoration priorities if a PRTC wire center is inoperative. In addition, PRTC should demonstrate that it will provide these services within the same intervals it provides for itself for DS1 and DS3 special access and switched transport

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[56] See Virtual Collocation Order, 9 FCC Rcd at 5173.

[57] See Designation Order at ¶¶ 108-109; see also Virtual Collocation Order, 9 FCC Rcd at 5172.

services. Given PRTC's statement that it will honor the Commission's Virtual Collocation Order requirements in this regard,[58] PRTC should be required to document its obligations in its tariff so that the parties have a clear and thorough understanding of the terms and conditions underlying a given tariff offering, as required by the Commission's rules.

CONCLUSION

For the foregoing reasons, CoreComm respectfully requests that the Commission reject PRTC's VEIS tariff as unjust and unreasonable in contravention of Sections 201 and 202 of the Communications Act and prescribe rates, terms and conditions consistent with the Act and the Commission's rules.

Respectfully submitted,

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Dated: April 25, 1997

F1/65420.1

[58] PRTC Direct Case at 28.

ATTACHMENT

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April 21, 1997

VIA COURIER

Hon. Regina Keeney
Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

Dear Ms. Keeney:

I am writing to seek clarification of a letter ruling (copy attached) issued by your predecessor on July 1, 1985, concerning certain accounting procedures applicable to Puerto Rico Telephone Company ("PRTC"). Our client, KMC Telecom Inc. ("KMC"), is currently engaged in an arbitration proceeding with PRTC before the Puerto Rico Telecommunications Regulatory Board ("Board") under Section 252 of the Communications Act of 1934. Because the Board is required by statute to issue its arbitration decision no later than June 11, 1997, we respectfully request an expedited response to this letter.

PRTC has alleged in the arbitration proceeding that the Bureau's 1985 letter, concerning the accounting treatment of the Section 936 tax credit for purposes of setting interstate access rates, should be treated as a precedent in measuring PRTC's "cost" for purposes of setting rates for unbundled network elements pursuant to Section 252(d) of the Communications Act. Based upon the contents of the 1985 letter, however, we believe that the Bureau's position on the accounting issue described therein was based on a specific set of facts, including among others that:

1) the statutory purpose of Section 936 is to stimulate development in Puerto Rico;

2) PRTC was a member of the NECA access pool; and

3) therefore, if the benefit of the Section 936 tax credit were reflected in interstate access charges, this benefit would be passed through to all ratepayers of NECA member companies and not necessarily to Puerto Rico consumers.

Here, by contrast, if the benefit of Section 936 were reflected in rates for unbundled elements, it would benefit either businesses investing in Puerto Rico, their Puerto Rican customers, or both.

In addition, in 1985, PRTC held a legal monopoly, and therefore its receipt of compensation (from ratepayers of other NECA pool members) for federal income tax payments that it did not make would not disrupt a competitive balance. Today, by contrast, Congress has mandated competition in the local exchange market. PRTC's receipt of compensation (from KMC and other CLECs) for federal income tax payments that PRTC does not make would disrupt the efforts of Congress and the FCC to establish a "level playing field" for competition between PRTC and CLECs such as KMC.

We therefore request that the Bureau clarify that the 1985 letter is applicable only for purposes of determining PRTC's interstate revenue requirement for access charges, based upon the specific facts considered by the Bureau in 1985, and does not represent the Bureau's position as to the appropriate method of determining PRTC's "cost" for purposes of Section 252(d). Please note that we are not requesting that the Bureau provide any affirmative guidance as to how PRTC's "cost" should be determined, but only clarification that the 1985 letter should not be relied upon as support for PRTC's position. Please feel free to contact us if you have any questions regarding this request.

Very truly yours,

Russell M. Blau
Counsel for KMC Telecom Inc.

Enclosure

cc: A. Richard Metzger, Jr., Deputy Bureau Chief
James D. Schlichting, Chief, Competitive Pricing Division
Kenneth Moran, Chief, Accounting and Audits Division
Thomas Power, Chief, Legal Branch, Competitive Pricing Division
Joe Dixon Edge (via facsimile)
Manuel A. Quilichini (via facsimile)
Eric J. Branfman
Antony R. Petrilla

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

IN REPLY REFER TO:

JUL 1 1985

Sr. Luis Gonzalez Monclava
Assistant Executive Vice President
Puerto Rico Telephone Company
G.P.O. Box 998
San Juan, Puerto Rico 00936

Dear Sr. Monclava:

This letter is in response to a May 29, 1985 letter from your attorneys which requested an accounting interpretation of Part 31 of the Commission's Rules on the Puerto Rico Telephone Company's (PRTC) behalf. Specifically, the letter requested the Commission to approve an accounting procedure under Part 31 which would implement the statutory purpose of Section 936 of the Internal Revenue Code. The statutory purpose of Section 936 is to stimulate economic development in Puerto Rico by providing tax credits to those domestic companies which conduct a significant portion of their business in Puerto Rico.

The request is predicated on the fact that Part 31 does not make explicit provision for the Section 936 credit. Absent such a provision, PRTC would show no federal income tax expense and without documentation of pre-credit tax expenses, the National Exchange Carrier Association (NECA) will not reimburse PRTC for the interstate portion of federal income taxes.

PRTC maintains that if it is not reimbursed for the pre-credit tax liabilities, it would not receive a tax benefit or saving from the interstate portion of the Section 936 credit. While the credit would eliminate any actual federal tax payment, PRTC would be no better off than if it did not qualify for the credit and paid taxes. This is because NECA reimburses exchange carriers for federal tax on income from interstate services, leaving them with no net out of pocket interstate tax cost. Thus, if PRTC is not reimbursed, the tax dollars that would be saved from payment to the Treasury would be passed on to all interstate ratepayers in NECA's jurisdiction. The letter stated that, contrary to the policy of Section 936, this "flow through" to the interstate ratepayers violates Section 936's explicit provision for a special tax savings for qualifying Puerto Rican businesses.

Moreover, the letter explained that the tax benefits provided by Section 936 in the past have been used by the company to implement an extensive capital improvement program. The money reimbursed by NECA would be used in much the same way or to lower local rates.

The procedure PRTC suggested to recognize the Section 936 credit is to record 1) the pre-credit tax expense in Account 306 "Federal income taxes-operating" 2) the Section 936 tax credit in Account 402 "Miscellaneous credits to retained earnings" and 3) the reimbursement from NECA for the pre-credit tax expense in Account 500 "Operating revenues". PRTC forwarded two other alternatives for recognizing Section 936 transactions but regardless of the accounting treatment, PRTC also requested that we approve the exclusion of the Section 936 credit from PRTC's calculation of its rate of return for interstate services.

After reviewing Part 31 and the nature of the Section 936 credit, we have decided that an interpretation is necessary so that the Section 936 credit will be adequately documented for NECA. We are doing so based on our understanding of the Congressional intent of Section 936 of the Internal Revenue Code, which is to provide domestic companies with a tax incentive to invest in Puerto Rican enterprises. The benefit PRTC derives from the Section 936 tax credit, we believe, should not be eliminated because of the Commission's Rules.

Another reason for granting your request is that PRTC is a state owned corporation and thus, the citizens of Puerto Rico will receive the benefit of Section 936 because the monies received will be used to improve service or reduce rates in Puerto Rico. Had PRTC been a privately-owned company we might have reached a different conclusion.

With respect to PRTC's suggested accounting procedure, we cannot allow PRTC to bypass the income accounts by recording the Section 936 credit directly to retained earnings in Account 402. Instead, PRTC should record the pre-credit tax expense in Account 306 and the Section 936 credit in Account 316 "Miscellaneous income". The NECA reimbursement should be recorded in the appropriate account or accounts in the 500 series of accounts on the basis of the NECA pool to which the revenues relate. Part 31 allows Account 316 as optional treatment for investment tax credits. The Section 936 credit is somewhat analogous to the investment tax credit. Like an investment tax credit, the Section 936 credit was intended by Congress to stimulate investment and produce a desired economic result. But it cannot be tied to the service life of particular assets or groups of assets. For these reasons, we believe the use of Account 316 is appropriate.

In order to preserve PRTC's rate of return, we are considering the Section 936 credit amount recorded in Account 316 as a nonoperating item which is to be excluded from ratemaking and separations treatment. PRTC must provide appropriate explanatory reference to Account 316 in its Form M filings.

A copy of this letter is also being sent to NECA so that there is no misunderstanding.

Sincerely,

Albert Halprin
Chief, Common Carrier Bureau

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